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April 11, 1997

Curry and Curry, Attorneys at Law
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Dear Mr. Curry:

This is in response to your letter of January 24, 1997 to Assistant Chief Counsel Larry Augusta in which you inquire as to the change in ownership consequences for real property owned by a partnership when partnership interests are transferred upon the death of a partner. You present a set of facts describing transfers of partnership interests and ask whether each transfer constitutes a change in ownership of the real property owned by the partnership. The basic facts set forth in your letter are as follows: Bill and Jack form a partnership named **BILL AND JACK'S PARTNERSHIP** with each owning a 50 percent interest. They file a partnership statement which does not include a provision for continuation of the partnership upon the death of a partner and acquire real property held in the name of the partnership. Bill dies and his 50 percent partnership interest passes to his wife, Mary. Jack accepts Mary as a new partner and Jack and Mary file a second partnership statement listing themselves as the partners in **BILL AND JACK'S PARTNERSHIP**. The second partnership statement does not include a provision for continuation of the partnership upon the death of a partner. Thereafter, Jack dies and his 50 percent partnership interest passes to his son, Ben. Mary and Ben become partners and file a partnership statement listing themselves as partners in **BILL AND JACK'S PARTNERSHIP**.

You ask the following questions, 1 and 2, based on the above facts and with the variations in questions 3 and 4.

1. Would there be a change in ownership of the real property effected by Jack accepting Mary as an equal co-partner?
2. Will a reappraisal of any interest in the partnership real property be required as a result of Jack's death and Ben's succession to his partnership interest and Mary's accepting him as an equal co-partner? Can Ben claim exclusion from the reappraisal under Proposition 58?

3. If Ben and Mary did not form a partnership after Jack's death, but instead Mary became the sole owner of the real property as a surviving partnership tenant, subject to her duty to account to Ben for Jack's partnership interest, would there be a change in ownership and a reappraisal required as the result of Jack's death? Would it make any difference if there had been agreements for continuation of the partnership and substitution of Bill's wife Mary as a partner in the event of his death and then subsequently an agreement between Mary and Jack for Jack's son Ben to be a partner with Mary in the event of Jack's death?

4. If Jack's 50 percent interest descended not just to Ben, but to Ben and two siblings so that each of them in effect acquired a one-sixth interest in the partnership and all three of them, with their total of a one-half partnership interest were accepted by Mary as new partners with her and a partnership statement to that effect was filed reflecting that Mary was a 50 percent partner in BILL AND JACK'S PARTNERSHIP and each of Jack's three children the owner of one-sixth, or 16.6666 percentage interest in the partnership, would the property tax consequences change?

In the discussion that follows, the transfers are separately analyzed as those in which the partnership agreement did not include a provision for continuation upon the death of a partner and those where the partnership agreement did include a continuation provision.

To summarize our analyses and conclusions which are set forth in detail below:

Where the partnership agreement does not provide for a continuation of the partnership, the death of a partner results in a dissolution of the partnership. Upon the partner's death, the deceased partner's partnership interest is immediately transferred to his or her heir even though the partnership may continue after dissolution until winding up is completed. In the first instance, Bill's 50 percent partnership interest is transferred to his wife, Mary, although she does not become a partner, and Jack retains his 50 percent interest. The transfer to Mary is excluded from change in ownership under Revenue and Taxation Code section 63, the interspousal exclusion, or under Revenue and Taxation Code section 64(a), transfers of partnership interests.

To become partners, Jack and Mary may form the new partnership either by having the dissolved partnership transfer the partnership real property to the new partnership or by distributing the real property from the dissolved partnership to themselves and then transferring the real property to the new partnership. Either means of creating the new partnership will result in a change in ownership of the real property. In the former, the transfer would be from the dissolved partnership with Jack as partner to the new partnership with Jack and Mary as partners. In the latter, the transfer would involve two steps. The first step would transfer real property from the partnership to Jack as a former partner and to Mary as Bill's heir. Since Jack and Mary had 50 percent partnership interests in the partnership property before the transfers and 50 percent interests as tenants in common in the real property after the transfers, Revenue and Taxation Code section 62(a)(2) exclusion would be applicable. In the second step, Jack and Mary would transfer the real property to the new partnership having themselves as equal partners. Although Jack and Mary would have 50 percent interests in the real property before the transfers and 50 percent interests in the new partnership after the transfers and the section 62(a)(2)

exclusion could be applicable, the transfers would result in changes in ownership under the step transaction doctrine.

When Jack dies, that partnership dissolves and his partnership interest is transferred immediately to his heir, Ben, who similarly does not become a partner. When Mary and Ben become partners, they also form a new partnership. As in the foregoing analysis, the dissolved partnership may transfer the partnership real property to the new partnership or Mary and Ben may have the real property distributed to themselves and then transfer the real property to the new partnership. Again, either means will result in a change in ownership of the real property. The Proposition 58 parent/child exclusion is not applicable because that exclusion is available only for transfers of real property from parents and children, not for transfers of real property from legal entities. The transfer of Jack's real property to Ben would be a transfer from a legal entity.

If, after Jack died, the partnership dissolved, and Mary became the "sole owner" of the real property subject to a duty to account to Ben for Jack's former partnership interest, Mary would act as a trustee for Ben's interest in the real property, but there would be no transfer of partnership interests. There would be a change in ownership of the real property upon distribution but the section 62(a)(2) exclusion could exclude the transfer to Mary.

If the partnership agreement included a provision that the partnership was to continue in the event of the death of a partner, then that provision would be controlling. Hence, there would be no dissolution and no change in ownership upon the death of a partner in any of the foregoing situations.

LEGAL ANALYSIS

Section 60 of the Revenue and Taxation Code¹ defines "change in ownership" as a "transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest."

Death of Bill and Dissolution of the Partnership

From the facts presented, the original agreement under which Bill and Jack formed the partnership did not provide that upon the death of Bill or Jack an heir of either one would succeed to his partnership interest nor did the agreement include a provision for continuation of the partnership upon the death of a partner. Under Corporations Code section 15031(4), dissolution of a partnership is caused by the death of any partner, unless otherwise provided in an agreement in writing, signed by all partners before such death or, pursuant to a 1987 amendment, in a court order made pursuant to Probate Code section 9762. As stated above, there was no such written agreement providing otherwise in this case. Thus, when Bill died there was a dissolution of the partnership under Corporations Code section 15031(4). On dissolution, the partnership was not terminated, but continued until the winding up of the partnership affairs was completed under Corporations Code section 15030.

¹ Hereinafter, all section references are to the Revenue and Taxation Code, unless otherwise specified.

Under California property tax law, transfers of interests in real property, including transfers of interests in legal entities holding real property, occur upon the death of the owner. Specifically, Property Tax Rule 462.260(c) states that the date of change in ownership of real property for reappraisal purposes is the date of death of the owner. In adopting this provision of the Rule, the Board of Equalization relied on California Probate Code section 7000, which expressly states:

Subject to Section 7001, title to a decedent's property passes on the decedent's death to the person to whom it is devised in the decedent's will or, in the absence of such a devise, the decedent's heirs as prescribed in the laws governing intestate succession.

Thus, at Bill's death, his 50 percent partnership interest immediately transferred to his wife, Mary, although she did not thereby become a partner. Jack remained as the surviving partner solely for the purpose of winding up the dissolved partnership and to account to Mary for Bill's share.

The transfer of Bill's partnership interest to Mary upon his death would be excluded from change in ownership under Section 63 or under Section 64(a).

Section 63 provides:

Notwithstanding any other provision in this chapter, a change in ownership shall not include any interspousal transfer, including, but not limited to:

...
(b) transfers which take effect upon the death of a spouse.

Since Section 63 applies to any transfer between spouses, we have been of the opinion that it applies to both transfers of real property and transfers of interests in legal entities.

Section 64(a) provides:

(a) Except as provided in subdivision (h) of Section 61 and subdivisions (c) and (d) of this section, the purchase or transfer of ownership interests in legal entities, such as corporate stock or partnership or limited liability company interests, shall not be deemed to constitute a transfer of the real property of the legal entity. This subdivision is applicable to the purchase or transfer of ownership interests in a partnership without regard to whether it is a continuing or dissolved partnership.

Section 64 treats partnerships as entities. When a partnership is dissolved by the death of a partner, it retains its legal existence as an entity for the limited purpose of winding up, with the result that the surviving partner continues to hold his 50 percent partnership interest and the heir receives the deceased partner's 50 percent partnership interest. Thus, Jack's and Mary's interests in the partnership's property are vested upon dissolution, but they do not become possessory until actual liquidation and distribution of the partnership's property, including real property. Since the exceptions provided in Section 61(h) and Section 64(c) and (d) are not applicable, the transfer of

Bill's 50 percent partnership interest to Mary is excluded from change in ownership pursuant to Section 64(a). Section 64(c) is not applicable because the transfer of the 50 percent interest is not a transfer of a majority ownership interest in the partnership.

Jack and Mary Become Partners

By agreeing to become partners, Jack and Mary effectively form a new partnership either by having the dissolving partnership transfer the partnership real property to the new partnership or by distributing the real property from the partnership to themselves and then transferring the real property to the new partnership. The transfer or transfers from the dissolving partnership with Jack as partner to the new partnership with Jack and Mary as partners will result in a change in ownership of the real property. Board Property Tax Rule 462.180 (Title 18, Cal. Code of Regs. sec. 462.180) which interprets section 60 provides in relevant part that

Except as is otherwise provided in subdivision (b), the transfer of any interest in real property to a corporation, partnership, or other legal entity is a change in ownership of such real property transferred.

Thus, as the result of the transfer from the dissolving partnership with Jack as partner to the new partnership with Jack and Mary as partners, there would be a change in ownership of the real property.

The transfer from the dissolved partnership to Jack as the former partner and to Mary as Bill's heir would also be a change in ownership under section 61(i). Section 61(i) provides

Except as is otherwise provided in Section 62, change in ownership, as defined in Section 60, includes, but is not limited to:

* * *

(i) The transfer of any interest in real property between a corporation, partnership, or other legal entity and a shareholder, partner, or any other person.

As the result of the transfers from the dissolved partnership, the real property would pass from the partnership to Jack and Mary as individuals.

It should be noted that section 62(a)(2) excludes from change in ownership, legal entity-to-individual transfers of the same proportional ownership interests in the real property. Specifically, section 62(a)(2) provides, in pertinent part, that

Change in ownership shall not include:

(a) . . .

(2) Any transfer between an individual or individuals and a legal entity or between legal entities, such as a cotenancy to a partnership, a partnership to a corporation, or a trust to a cotenancy, which results solely in a change in the method of holding title to the real property and in which proportional ownership interests of the transferors and transferees, whether represented by stock, partnership interest, or otherwise, in each and every piece of real property transferred, remain the same after the transfer.

Thus, if the partnership transfers of the partnership real property to Jack and Mary were in the same proportional interests, the transfers could be excluded from change in ownership under Section 62(a)(2). Thereafter, when Jack and Mary transferred the real property to the new partnership, having themselves as equal partners, although Jack and Mary would have 50 percent interests in the real property before the transfers and 50 percent interests in the new partnership after the transfers, and although the section 62(a)(2) exclusion could be applicable, the transfers would result in changes in ownership under the step transaction doctrine.

The second transfer requires that Jack and Mary transfer their equal interests in the real property into the new partnership in exchange for equal partnership interests. As in the last transfer, there is a change in ownership under section 61(i) as a transfer of real property between partners and a partnership. Though again, section 62(a)(2) excludes this transfer from change in ownership because the transfer changes the method of holding title while the proportional ownership interests remain the same. In our view, notwithstanding the section 62(a)(2) exclusion afforded both transfers, the combination of these two transfers would be subject to the step transaction doctrine.

The "step transaction doctrine" has been applied to real property transfers when unnecessary steps are taken merely to circumvent the intent of the change in ownership statutes; in which case, the "substance of the transaction, rather than the form" will determine if a change in ownership has actually occurred. *Shuwa Investment Corp. v. County of Los Angeles* (1991) 1 Cal.App.4th 1635. To determine whether particular circumstances warrant "stepping" together multiple transactions to arrive at the substance of a transaction, courts have developed three principal tests - end result, interdependence and binding commitment.

In this instance, it appears that the "end result test" compels the conclusion that the two transfers should be stepped together. "Under the 'end result test', purportedly separate transactions will be amalgamated with a single transaction when it appears that they were really component parts of a single transaction intended from the outset to be taken for the purpose of reaching the ultimate result." *Shuwa Investment Corp. v. County of Los Angeles* (1991) 1 Cal.App.4th 1635, 1650. Here it appears the two steps were really component parts of a single transaction. The ultimate result intended from the outset was for Jack and Mary to become partners in the new partnership.

Death of Jack and the Parent/Child Exclusion

Upon Jack's death, the partnership dissolved and Jack's partnership interest was transferred to the successor in interest, his son Ben, though Ben did not become a partner. For purposes of this analysis, we assume that the partnership agreement executed by Mary and Jack did not authorize their heirs to participate as partners nor did the agreement provide for continuation of the partnership upon the death of a partner. The disposition of Jack's partnership interest and the effect on the partnership is subject to part of the same analysis as that applied after Bill's death. When Jack dies, that partnership dissolves and his partnership interest is immediately transferred to his heir, Ben, who similarly does not become a partner. The transfer to Ben would be excluded from change in ownership under Section 64(a).

When Ben and Mary become partners, they also form a new partnership. The dissolving partnership may transfer the partnership real property to the new partnership or Mary and Ben may have the real property distributed to themselves and then transfer the real property to the new partnership. Again, either means will result in a change in ownership of the real property. See the Jack and Mary Become Partners section, above.

With regard to your question about the Proposition 58 parent-child exclusion, the transfer involved here would not be excluded as a parent/child transfer because by its terms the exclusion is applicable only for transfers of real property from parents and their children, not for transfers of real property from legal entities. In these instances, the real property would be transferred from partnership to partnership or from partnership to child (Ben). Proposition 58 which excluded certain transfers between parents and children is codified as section 63.1 of the Revenue and Taxation Code. Under section 63.1, only transfers of real property between "eligible transferors" and "eligible transferees" are excluded. Section 63.1 provides in relevant part:

(a) Notwithstanding any other provision of this chapter, a change in ownership shall not include the following purchases or transfers for which a claim is filed pursuant to this section:

...

(2) The purchase or transfer of the first one million dollars (\$1,000,000) of full cash value of all other real property of an eligible transferor in the case of a purchase or transfer between parents and their children.

...

(c) As used in this section:

(1) "Purchase or transfer between parents and their children" means either a transfer from a parent or parents to a child or children of the parent or parents or a transfer from a child or children to a parent or parents of the child or children . . .

* * *

6) "Eligible transferor" means a grandparent, parent or child of an eligible transferee.

(7) "Eligible transferee" means a grandparent, parent, child or grandchild of an eligible transferor.

(8) "Real property" means real property as defined in Section 104. Real property does not include any interest in a legal entity.

Upon Jack's death, when the partnership dissolves and the real property is distributed, the partnership transfers the real property to Ben. The transferor is the partnership, not the parent, and subdivision (c)(6) does not include a partnership as an eligible transferor.

Jack's Interest Bequeathed to Three Children

In another part of your letter you describe a situation in which Jack's interest passes to and is divided among his three children who then each hold a 16.6666 percent interest in the partnership. Again, we assume for purposes of analyzing this transaction that the partnership agreement does not provide for the children to participate as partners or for the partnership to continue if a partner dies. The addition of children does not change our conclusion regarding the transfer of the right to a deceased partner's partnership interest to his heirs and the subsequent forming of a new partnership.

Jack Dies and Mary Becomes "Sole Owner"

In the next fact variation, Jack dies and the partnership dissolves and Mary became the sole surviving partner, subject to a duty to account to Ben for Jack's former partnership interest which is bequeathed to Ben. Again, we assume for purposes of the analysis that the partnership agreement does not specifically provide for continuation of the partnership and therefore, dissolution of the partnership occurs upon Jack's death. Pursuant to Corporations Code section 15043, Ben, as Jack's heir and legal representative, has a right to an accounting as against Mary, the winding up or surviving partner.

When the partnership dissolves, Mary assumes exclusive authority for purposes of winding up the partnership and it may be argued that Mary, as the sole remaining partner, thereby acquires control of the partnership resulting in a change in ownership. However, it is our view that a surviving partner (following the deaths of other partners) who has been charged with winding up the partnership has not, thereby, obtained partnership interests which would confer ownership or control within the meaning of Section 64(c).

Even though Mary held sole voting power and decision-making authority over the partnership affairs for the purpose of winding up, she did not obtain more than 50 percent of the partnership capital and profits. As the surviving partner, Mary merely assumed the duties of partner prescribed by the Corporations Code. Corporations Code Sections 15033 through 15038 set forth the rights, authority and liabilities of partners upon dissolution. Specifically, section 15037 provides in relevant part that "[u]nless otherwise agreed the partners who have not wrongfully dissolved the partnership . . . [have] the right to wind up partnership affairs . . .

.” The surviving partner becomes, in effect, a trustee for the estate of the deceased partner in that she has the right to possession and control of all the partnership property until the affairs of the partnership are wound up, but receives no vested or beneficial interest in the deceased partner’s share of the partnership or its assets. *Freeman v. Donohoe* (1923) 65 Cal.App. 65, 87. Therefore, Mary would be empowered to wind up the partnership by statutory authority and act as a trustee for Ben’s interest in the former partnership assets but there would be no transfer of partnership interests. Thus, section 62(a)(2) would similarly be available to exclude the transfers of real property from change in ownership since before and after the transfer, the proportional ownership interests of Mary and Ben in the real property transferred would be the same.

Partnership Agreement Includes Continuation Provision

In the alternative scenario you present, Bill and Jack’s partnership agreement provides that upon Bill’s death the partnership shall continue and Mary shall become a partner by assuming Bill’s 50 percent partnership interest. Notwithstanding the statutory provision for dissolution on death of a partner, an agreement between the partners to continue the partnership is controlling in this instance and no change in ownership would occur, in this instance not only because a 50 percent partnership interest would be the interest being transferred (Section 64(a)) but also because Mary was Bill’s wife (Section 63). As stated above, pursuant to Corporations Code section 15031(4), the death of a partner dissolves a partnership “unless otherwise provided in an agreement in writing signed by all the partners before such death . . .” Likewise, such a continuation provision in the partnership agreement between Jack and Mary would be controlling as well.

The views expressed in this letter are, of course, advisory only. They are not binding on the Merced County Assessor or the assessor of any county.

Very truly yours,



Louis Ambrose
Tax Counsel

LA:ba

cc: Honorable David A. Cardella, Merced County Assessor
Mr. James Speed, MIC:63
Mr. Richard Johnson, MIC:64
Ms. Jennifer Willis, MIC:70

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220.0525 **Partnership/Control.** The ABC Partnership is owned by the XY Partnership (64 percent), X as an individual (20 percent), and X and his wife as coowners (16 percent). X and Y each have a 50 percent interest in the XY Partnership.

The XY Partnership is terminated by Y's death, and X receives his 50 percent interest (32 percent interest in ABC Partnership) which, when combined with his individual 20 percent interest and 8 percent interest (half of the 16 percent owned with his wife), increases his ownership interest in the ABC Partnership to 60 percent. A change in control has occurred under Revenue and Taxation Code section 64(c), resulting in a change in ownership of the property owned by the ABC Partnership. The result would be different if X had already acquired control of ABC Partnership by owning more than 50 percent of the XY Partnership at the time of Y's death. C 5/18/89. (M99-1)